

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Waycross Division

In the matter of:)	
)	Adversary Proceeding
SCOTT HOUSING SYSTEMS, INC.)	
(Chapter 7 Case <u>86-50123</u>))	Number <u>88-5066</u>
)	
Debtor)	
)	
)	
JAMES D. WALKER, JR.,)	
TRUSTEE)	
)	
Plaintiff)	
)	
v.)	
)	
WAYCROSS PAINT AND WALL)	
COVERINGS)	
)	
Defendant)	

MEMORANDUM AND ORDER

On April 1, 1991, a hearing was held on a Motion to Avoid Preferential Transfers pursuant to 11 U.S.C. Section 547 filed by the Chapter 7 Trustee. The Plaintiff and the Defendant stipulated to all pertinent facts regarding the transfers at issue. At the close of the hearing I ordered the parties to supplement the record with a sample of the invoices sent to the Debtor by Defendant. The record was supplemented by letter of April 9, 1991. Based upon the stipulations of the parties, the arguments of counsel, the briefs and other documentation submitted, as well as applicable authorities, I make the following Findings of Fact and Conclusions of Law.

FINDINGS OF FACT

The Debtor Corporation filed a petition under Chapter 11 of the Bankruptcy Code with this Court on August 25, 1986. The case was converted to Chapter 7 on April 8, 1987, and the Trustee was appointed as Interim Trustee by Order of the Court on that date. On May 12, 1987, the Trustee was appointed Permanent Trustee by the Office of the United States Trustee.

The Defendant, Waycross Paint and Wall Coverings ("Waycross Paint"), was a trade creditor of the Debtor. In the 90 day period prior to filing, while the Debtor was presumed to be insolvent,¹ numerous transfers were made by the Debtor to Waycross Paint as payments for antecedent debts. The transfers enabled Waycross Paint to receive more than it would have received in a Chapter 7 liquidation proceeding in that the maximum funds available for distribution to unsecured creditors including funds on hand, collection of judgments, unpaid preferential settlements, and the maximum recovery in the remaining pending preference cases would be \$321,208.53, whereas the priority tax claims filed exceed \$770,000.00. Therefore, there will be no distribution to unsecured creditors in this case.

The Trustee does not seek avoidance of every transfer made by the Debtor to Waycross Paint during the preference period but does seek avoidance of the following transfers:

1) Payment of \$5,217.79 on account by check number 36216, dated May 14, 1986, received by the Defendant on May 27, 1986, which cleared the Debtor's bank account on June 1, 1986, and

¹ See 11 U.S.C. §547(f).

which was for payment of the following invoices:

<u>INVOICE NUMBER</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>
20430	3-11-86	\$ 56.95
20444	3-11-86	40.50
20445	3-11-86	175.75
20446	3-11-86	730.00
20447	3-11-86	28.00
20448	3-11-86	2,563.50
20489	3-13-86	1,150.09
20507	3-13-86	146.00
20525	3-14-86	185.25
20533	3-14-86	13.95
20534	3-14-86	21.30
20541	3-15-86	106.50

2) \$4,494.79 which represents part of a payment of \$5,735.29 on account by check number 37542, dated June 9, 1986, received by the Defendant on June 10, 1986, and which was for payment of the following invoices:

<u>INVOICE NUMBER</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>
20497	3-17-86	\$ 2.86
20565	3-28-86	10.69
20566	3-17-86	304.11
20570	3-17-86	21.30
20578	3-18-86	441.00
20587	3-18-86	42.60
20588	3-18-86	53.25
20596	3-19-86	182.50
20608	3-19-86	73.00
20613	3-19-86	932.80
20630	3-20-86	73.00
20637	3-21-86	103.20
20638	3-21-86	69.95
20666	3-24-86	1,109.00
20672	3-24-86	202.35
20692	3-25-86	61.33
20708	3-26-86	159.75
20712	3-27-86	40.80
20715	3-26-86	42.60
20730	3-27-86	568.00

3) Payment of \$5,270.10 on account by check number 37986, dated June 17, 1986, received by the Defendant on June 18, 1986, which cleared the Debtor's bank account on June 24, 1986, and which was for payment of the following invoices:

<u>INVOICE NUMBER</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>
20691	3-25-86	\$ 28.00
20804	4-01-86	2,766.98
20806	4-01-86	407.90
20812	4-01-86	182.50
20822	4-02-86	1,434.50
20856	4-03-86	200.23
20860	4-03-86	235.00
20862	4-03-86	14.99

4) Payment of \$2,382.44 on account by check number 38332, dated June 24, 1986, received by the Defendant on June 25, 1986, which cleared the Debtor's bank account on June 30, 1986, and which was for payment of the following invoices:

<u>INVOICE NUMBER</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>
20821	4-02-86	\$ 106.50
20904	4-07-86	150.00
20905	4-07-86	7.19
20908	4-07-86	73.00
20909	4-07-86	195.50
20912	4-07-86	25.18
20914	4-07-86	530.00
20926	4-08-86	881.50
20929	4-08-86	217.00
20939	4-08-86	12.59
20953	4-09-86	21.30
20956	4-09-86	25.18
20957	4-09-86	28.00
20963	4-10-86	109.50

5) Payment of \$6,887.75 on account by check number 38565, dated July 1, 1986, received by the Defendant on July 7, 1986, which cleared the Debtor's bank account on July 10, 1986, and which was for payment of the following invoices:

<u>INVOICE NUMBER</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>
20948	4-09-86	\$3,010.58
20981	4-11-86	25.18
21026	4-15-86	85.00
21027	4-15-86	730.00
21029	4-15-86	2,898.60
21046	4-16-86	138.37

6) \$3,735.11 which represents part of a payment of \$4,197.06 on account by check number 38791, dated July 8, 1986, received by the Defendant on that same date and which cleared the Debtor's bank account on July 11, 1986, and which was for payment of the following invoices:

<u>INVOICE NUMBER</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>
21057	4-24-86	\$ 118.00
21132	4-22-86	1,016.50
21140	4-22-86	673.10
21158	4-24-86	1,609.50
21166	4-23-86	232.42
21194	4-25-86	12.59
21198	4-25-86	73.00

The total amount of the transfers which the Trustee seeks to avoid is \$27,987.98 (See Schedule A, exhibit to letter dated April 8, 1991, addressed to the Court and counsel by Mary G. Colley, attorney for the Chapter 7 Trustee).

Each of the aforementioned invoices contain the following language:

TERMS - NET 30 DAYS
Past Due Accounts Subject to 1 1/2% Service
Charge

The Trustee has not pursued the payment of the remaining invoices within the ninety (90) day period as preferential due to the fact that he concedes that payments within the forty-five (45) day period subsequent to the invoice due date would meet the "ordinary course" defense. The parties have agreed that Waycross Paint is entitled to offset any transfers deemed avoidable preferences by the subsequent value it provided to the Debtor in the amount of \$11,059.08 pursuant to 11 U.S.C. Section 547(c)(4). This reduces the amount the Trustee seeks to recover from Waycross Paint to \$16,928.90.

CONCLUSIONS OF LAW

The parties have stipulated that the transfers at issue were preferential within the meaning of 11 U.S.C. Section 547(b).²

² 11 U.S.C. §547(b) reads as follows:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made--

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title [11 USCS

Thus the only issue before the Court is whether some or all of the transfers made in the period between 46 and 90 days were subject to the "ordinary course of business" exception set forth in 11 U.S.C. Section 547(c)(2), which provides in relevant part:

(c) the trustee may not avoid under this section a transfer--

(2) to the extent that such transfer was--

- (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
- (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
- (C) made according to ordinary business terms.

In order to fall within the ordinary course of business exception, the burden is on the creditor asserting the ordinary course defense to establish each of the elements of Section 547(c)(2) by a preponderance of the evidence. 11 U.S.C. §547(g). Section 547(c)(2) provides that a debtor's otherwise preferential payments may not be avoided if the following conditions are satisfied. The payments must be (1) made as payments of debts incurred in the ordinary course of the debtor's business; (2) made

§§701 et seq.];

- (B) the transfer had not been made; and
- (C) such creditor received payment of such debt to the extent provided by the provisions of this title [11 USCS §§101 et seq.].

in the ordinary course of business between the debtor and the creditor; and (3) made according to ordinary business terms. In re Craig Oil Co., 785 F.2d 1563 (11th Cir. 1986).³

The purpose of the Section 547(c)(2) ordinary course defense is to protect recurring customary credit transactions incurred and paid in the ordinary course of business of the debtor and the transferee, In re Fulghum Constr. Corp., 872 F.2d 739 (6th Cir. 1989), to encourage continuing short term credit dealing with troubled debtors in order to forestall bankruptcy. O'Neill v. Nestle-Libby's P.R., Inc., 729 F.2d 35 (1st Cir. 1984). Thus, the main policy behind the ordinary course exception is to prevent preference laws from interfering with normal financial relations. See Desimone, Section 547(c)(2) of the Bankruptcy Code: The Ordinary Course of Business Exception Without the 45 Day Rule, 20 Akron L.Rev. 95 (1986).

The "ordinary course" exception of Section 547(c)(2) requires a two step analysis, both subjective and objective. Id. Subsections (A) and (B) require a subjective analysis to determine what the ordinary course of business or financial affairs between the debtor and transferee in fact was. 11 U.S.C. §547(c)(2)(A)(B). Waycross Paint has provided detailed proof that it was the established practice between these parties to allow late payment on account despite the "TERMS-NET 30 DAYS" language set out in the invoices. However, it is unnecessary to address that issue because Waycross Paint has failed to meet its burden of proving the objective element of Section 547(c)(2) contained in subsection (C),

³ The Craig Oil court cites a fourth condition, that the payments must be made within forty-five days of incurring the debts, but points out that the forty-five day requirement was eliminated by Congress in 1984.

that the transfers were made "according to ordinary business terms."

The language of Section 547(c)(2) is clearly in the conjunctive, requiring that each of the three subsections be proved. This conclusion is dictated by the plain language of the statute, which utilizes the conjunctive "and" rather than the disjunctive "or". In re Blanton Smith Corp., 37 B.R. 303, 306 (Bankr. M.D.Tenn. 1984). "The plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of its drafters'." United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed. 2d 709 (1989) [quoting Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571, 102 S.Ct. 3245, 3250, 73 L.Ed. 2d 973 (1982).]

The requirement that a transfer be made "according to ordinary business terms" necessitates an objective analysis and must be considered in the context of the business in which the parties are engaged. Terms which may be ordinary in the course of one type of business may not be ordinary in other kinds of business transactions. In re Production Steel, Inc., 54 B.R. 417, 423 (Bankr. M.D.Tenn. 1985). It cannot be proven solely by evidence of the course of dealings between the parties. That evidence is probative only of the Section (c)(2)(B) element of the defense. Rather, there must be evidence of what constitutes an "ordinary" transaction in the broader sense. The only evidence before the Court as to what constitutes "ordinary business terms" is the sample invoice which clearly states on its face "TERMS-NET 30 DAYS". These payments did not fall within that time frame. I will grant that the course of dealing between these parties has varied substantially from those terms over the years but, in the absence of additional proof I conclude that the terms set forth on the invoice are a true

reflection of the industry standard. Inasmuch as Waycross Paint has failed to meet its burden of proving each and every element of the "ordinary course of business exception" of Section 547(c)(2), and the elements of a preferential transfer have otherwise been met, I find that the transfers at issue were preferential within the meaning of 11 U.S.C. Section 547(b), and judgment will be interest in favor of the Chapter 7 Trustee accordingly.

O R D E R

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that judgment be entered in favor of the Chapter 7 Trustee and against Waycross Paint and Wall Coverings in the amount of \$27,987.98.

IT IS FURTHER ORDERED that the judgment be offset pursuant to Section 547(c)(4) by the \$11,059.08 which the parties have agreed represents the subsequent value Waycross Paint provided to the Debtor, leaving the amount of \$16,928.90 subject to recovery.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This _____ day of May, 1991.